

## Cryptocurrencies: A Challenge for Tax Regulation

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# CRYPTOCURRENCIES: A CHALLENGE FOR TAX REGULATION

Alessandro Liotta<sup>1</sup>

## Abstract

The aim of this paper is to highlight the main problems deriving from cryptocurrencies in the field of taxation. First, the paper will give a glimpse at the key features of cryptocurrencies and Blockchain. Secondly, the paper will deal with the definition of this phenomenon and it will focus on the difficulties faced by different Institutions and entities, at European and International level, to provide a convincing and homogeneous definition of cryptocurrencies. The paper will provide a comparative overview of some different definitions to give an idea of how difficult it is to identify what cryptocurrencies are. Finding out the correct definition is not important as such, but it represents the first step to understand how to tax revenue deriving from cryptocurrencies. In fact, various economically relevant activities are involved in the world of cryptocurrencies, such as mining or exchanging, and such activities need to be taxed. In this scenario, the current legislative framework is not up to date and obsolete and requires robust amendments. How should revenue deriving from cryptocurrencies be taxed? An answer has been given by the Italian Tax Administration, which has issued two responses, following the judgment of the ECJ which, however, do not seem to be conclusive. In fact, the Italian Tax Code does not set forth any provisions regarding cryptocurrencies and the Tax Administration had to interpret the existing provisions. In addition, the paper will explore the approach of a Notice issued by the US Internal Revenue Service (IRS Notice 2014-21, March 25, 2014) and the one adopted by the Virtual Currency Tax Reform Act, which is supposed to give a definitive solution to the problem of taxation in the US. In conclusion, the paper will pose some questions regarding the ability of the tax systems to deal with issues related to cryptocurrencies.

**Keywords:** Tax Blockchain Bitcoin Regulation

## 1. Introduction: the essentials of Blockchain and cryptocurrencies

The law systems are not usually able to keep up with technological developments and struggle to acknowledge and regulate their most innovative elements. The inadequacy of such systems is evident when it comes to deal with cryptocurrencies<sup>2</sup>. Despite Blockchain – the technology cryptocurrencies are based on – was ideally born in 1991<sup>3</sup> and Bitcoin was theorized in 2008<sup>4</sup> by some authors under the pseudonym of Satoshi Nakamoto, lawmakers and regulators have been caught by surprise<sup>5</sup>.

The impact Blockchain and cryptocurrencies may have on transactions is still unpredictable, considering the speed of evolution of these technologies and the difficult task of creating an acceptable and shared definition

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<sup>1</sup> Master of Laws at Università degli Studi di Palermo, LL.M. in International Tax Law at King's College London, PhD candidate in "Law and Business", LUISS Guido Carli (Rome), Faculty of Law, with a dissertation in Tax Law on the application of anti-avoidance provisions to IP Holding Companies. Visiting Researcher at UNIL and Visiting Scholar at UC Berkeley, Boalt Hall Law School. Member of the Science Center of Public Finances and Tax Law at Vilnius University. Main interests: Tax Law, both from a domestic and an international perspective, and EU Law issues, especially those related to Tax Law. Email address: [aliotta@luiss.it](mailto:aliotta@luiss.it)

<sup>2</sup> For a thorough introduction of the concept of currency and its relationship with bitcoin, see KIEN-MENG LY M., 'Coining Bitcoin's "Legal Bits": Examining the Regulatory Framework for Bitcoin and Virtual Currencies, in Harvard Journal of Law & Technology, [2014], 27, 587.

<sup>3</sup> For a deeper study of the history of cryptocurrencies, see FRANKLIN M., 'A Profile of Bitcoin Currency: An Explanatory Study', in International Journal of Business and Economic Perspectives, [2016], 1, 80.

<sup>4</sup> NAKAMOTO S., 'Bitcoin: A Peer-to-Peer Electronic Cash System', [2008].

<sup>5</sup> It is possible to spot the uncertainties regarding the concept of cryptocurrencies by mentioning the guidelines issued by some American States. In this respect see. HUGHES S.J. – MIDDLEBROOK S.T., 'Are These Game Changers? Developments in the Law Affecting Virtual Currencies, Prepaid Payroll Cards, Online Tribal Lending, and Payday Lenders', in The Business Lawyer, [2014], 70, 261. The Authors point out that "At state level, regulators in California, Connecticut, Indiana, Nevada, New Mexico and Texas all issued statements or guidance related to virtual currency activities in their respective states. In addition, New York announced that it would consider formal applications from entities wishing to establish and operate regulated virtual currency exchanges within the state".

of these phenomena<sup>6</sup>. Although the Financial Action Task Force (FATF) has created a sort of dictionary<sup>7</sup> that sums up and classifies cryptocurrencies, the uncertainties wafting around virtual currencies are considerable.

In any case, it is nowadays impossible to deny the potential of the Blockchain technology and the very existence of a *real virtual world*<sup>8</sup> cannot be put aside or considered as a marginal phenomenon, especially if we consider its impact and its ability to affect the “real world”. This paper is not deemed to focus on the various, albeit interesting, aspects of Blockchain, but it is rather going to deepen some issues regarding the regulation of cryptocurrencies. However, it is necessary to identify the key elements that characterize the technology at issue, in order to better address the topic of this paper.

Bitcoin and other similar virtual currencies are based on a consensus network, that allows an unprecedented payment system. It consists in a decentralized peer-to-peer payment network, powered by its users, with no intermediaries or central authorities. As a matter of facts, the Bitcoin network is not owned by anyone and it shares a public ledger known as Blockchain<sup>9</sup>, where it is possible to find information regarding all the transactions occurred, allowing, thus, the users to verify the validity of such transactions.

The authenticity of each transaction is protected by cryptography and digital signatures, allowing all the users to have full control over the bitcoins sent from their “Bitcoin account”.

In addition, each user can process the transactions using the computing power of hardware systems and receive, in exchange, a sum in bitcoin for this type of service (so-called mining activity). More specifically, such an activity consists in the use of advanced computing power to process transactions, keep the network safe and synchronized all the members of the system<sup>10</sup>.

A transaction regarding bitcoin usually involves the following entities: a subject sending bitcoins who starts a transaction in the network; a subject who receives and accepts these bitcoins; the miners, who check the validity of the transaction; the Bitcoin development team, that update the system, if required; and the Bitcoin currency exchange team, that make the exchange of cryptocurrencies easier.

As it is possible to understand from the previous description, the main features of the Blockchain technology can be enlisted as follows: it can act as a public ledger; it is a global, transparent and shared system, that allows its users to monitor the activities taking place therein; it does not need any intermediaries or regulatory

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<sup>6</sup> It is worth noting that few Authorities have issue various, and often divergent, definitions of cryptocurrencies, which makes it even harder to deal with this topic. For instance, according to the European Bank Authority virtual currencies are “*digital representation of value that is neither issued by a central bank or a public authority nor necessarily attached to a fiat currency (FC), but is accepted by natural or legal persons as a means of exchange and can be transferred, stored or traded electronically*”. See Opinion on Virtual Currencies, EBA/op/2014/08, 10 (2014). Cryptocurrencies might be deemed as categories of virtual currencies that use cryptography to create new currencies and the control of transactions, allowing a decentralized system of transactions. See VIGNA P. – CASEY M.J., ‘Cryptocurrency: The Future of Money?’, Random House, [2016], 42. In addition, the National Payment System (NPS) Department of the South African Reserve Bank (SARB) stated “*A virtual currency (VC) is a digital representation of value that can be digitally traded and functions as a medium of exchange, a unit of account and/or a store of value, but does not have legal tender status*”. In this respect, see the Position Paper on Virtual Currencies, December 3<sup>rd</sup>, 2014, SARB 2014 <https://goo.gl/2nX9Tv>.

<sup>7</sup> Cryptocurrencies can be divided into several categories: centralized (that is to say linked to an administrative authority, like Webmoney or Perfect Money), decentralized (like Bitcoin, LitCoin and Ripple), non-convertible (which means that they do not have an equivalent in real currencies and they cannot be exchanged with any other currency, like Q Coins, World of Warcraft Gold and Project Entropia Dollars). See NIEMAN A., ‘A Few South African Cents’ Worth on Bitcoin’, in PER, [2015], 18, 1979. Depending on how virtual currencies are used to ease transactions, they can belong to one or another category. See also ANAND J., ‘Virtual Economies Virtually Unregulated: How Clear Taxpayer Guidance Can Mitigate Tax Compliance Risks’, in Hofstra Law Review, [2014], 43, 253.

<sup>8</sup> The existence of the *real virtual world* is highlighted by the so called *Bitnation*, where it is claimed that sovereignty is shifting from the State to the citizens. In this respect, see TARKOWSKI TEMPELHOF S., ‘Bitnation, Pangea Jurisdiction and Pangea Arbitration Token (PAT), The Internet Sovereignty’, <https://tse.bitnation.co/>. This sovereignty shift is said to be due to the lack of regulatory entities or of central authorities that have the power to issue currency or to control its movements.

<sup>9</sup> Literally, the term “*blockchain*” stems from the idea that transactions must be treated as parts (blocks) of a chain. A new block is added to the chain roughly every ten to twelve minutes, despite part of the process implies the solution of complex algorithms. In this respect, see ALLEN K., ‘A Bitcoin Primer’, Arizona Daily Star, 2014 [https://tucson.com/business/local/a-bitcoin-primer/article\\_aff0568e-bf71-5c88-b821-38c1b9c4e277.html](https://tucson.com/business/local/a-bitcoin-primer/article_aff0568e-bf71-5c88-b821-38c1b9c4e277.html). The Blockchain technology is used in the area of transfer pricing. See BILANEY S. K., ‘From Value Chain to Blockchain – Transfer Pricing 2.0’, in International Transfer Pricing Journal, [2018], 294.

<sup>10</sup> In this respect, see BRYANS D., ‘Bitcoin and Money Laundering: Mining for an Effective Solution’, in Indiana Law Journal, [2014], 441

authorities. Consequently, in the current legal framework it is hard to identify an economical or juridical category which cryptocurrencies may belong to<sup>11</sup>.

Although Bitcoin was initially meant to be used only as a tool for financial transactions, it has turned out to be a reliable currency and, since 2013, it has been increasingly used also in other contexts<sup>12</sup>.

It is thus surprising that such a widespread phenomenon has not been efficiently ruled and is still surrounded by an aura of uncertainty.

## 2. Definition(s) of cryptocurrencies

The concept of cryptocurrency is not so hard to imagine but tailoring a juridically incontrovertible convincing definition around it is not as easy. In fact, if we put the stress on any of its characteristics and consider any of them predominant over the others may give rise to different results.

For instance, cryptocurrencies might be analysed considering their purpose, that is to say, their ability to act as medium of exchange and store of value. According to the District Court of Texas, when it comes to defining cryptocurrencies it is necessary to stress their functions. In fact, since “[...] it is clear that Bitcoin can be used as money” as “[Bitcoin] can be used to purchase goods or services, and [...] used to pay for individual living expenses, [...] Bitcoin is a currency or a form of money”<sup>13</sup>.

However, if we look at the elements that traditionally belong to the concept of “money”, it might be claimed cryptocurrencies cannot be included in that category because they are not legal tender as they are not issued by any central authority<sup>14</sup>.

To make it clear, cryptocurrencies like Bitcoin are the result of an Internet protocol and, since they leave no physical sign (so-called paper trail), they may disappear by the very nature of Internet<sup>15</sup>. Based on this type of reasoning, on July 22<sup>nd</sup>, 2015, the District Court of Florida held Bitcoin was not money<sup>16</sup>. In fact, Judge Pooler dismissed the case of money laundering involving Bitcoin, stating that Bitcoin did not qualify as money, since it lacks any banks or governmental authorities and it cannot – to quote the Judge – “*be hidden under a mattress like cash and gold bars*”<sup>17</sup>.

According to the European Central Bank, cryptocurrencies may not be regarded as foreign currencies. In a recent Opinion, the ECB stated that the only recognized currency in the Monetary Union is the Euro and pointed out that cryptocurrencies should be considered as means of exchange, rather than proper currencies<sup>18</sup>.

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<sup>11</sup> As it will be further highlighted in the following section, cryptocurrencies have been alternatively deemed as goods, securities or financial instruments. In this respect, see TU V.K. – MEREDITH M.W., ‘Rethinking Virtual Currency Regulation in the Bitcoin Age’, in *Washington Law Review*, [2015], 271.

<sup>12</sup> See SMALL S., ‘Bitcoin: The Napster of Currency’, in *House Journal of International Law*, [2015], 581.

<sup>13</sup> SEC v Shavers, 2013, U.S. District. LEXIS 110018 (E.D. Texas August 6, 2013).

<sup>14</sup> In this respect, see CIRILLO A. – ATZENI C., ‘Aspetti operative, giuridici e fiscali delle criptovalute’, in *Amministrazione e Finanza*, [2018], 8, 27.

<sup>15</sup> An example of alternative and more structured and reliable cryptocurrency is the Unified System for Regional Compensation (SUCRE). The SUCRE was initially a cryptocurrency used for transactions between Ecuador and Venezuela and it was meant to replace the US dollar as a mean of exchange and to limit the control of US over South American trades and, simultaneously, to increase the level of stability of these markets. In this respect, see ALVARO M. – LEWIS J.T., ‘Who Needs Bitcoin? Venezuela has its “Sucre”’, [2014], <http://www.wsj.com/articles>. See also HURTADO C.R., ‘Fiscal Policies as Decisive Solutions for Troubled Economies: Differing Legislative Enactments in Argentina Ecuador’, in *Loyola L.A. International & Comparative Law Review*, [2014], 24, 391.

<sup>16</sup> Florida v Espinoza F14-2923, 6 (Florida District Court 2015).

<sup>17</sup> The case at issue regarded a web designer, Michell Espinoza, who was accused of money laundering because he had previously sold bitcoin to under-cover agents to buy stolen credit cards. For a deeper analysis of the case, see PIAZZA F., ‘Bitcoin in the Dark Web: A Shadow over Banking Secrecy and a Call for Global Response’, in *Southern California Interdisciplinary Law Journal*, [2017], 26, 521.

<sup>18</sup> See the Opinion of the European Central Bank (October 12<sup>th</sup>, 2016), § 1.1.3: “First, ‘virtual currencies’ do not qualify as currencies from a Union perspective. In accordance with the EU Treaties and the provisions of Council Regulation (EC) n. 974/98, the euro is the single currency of the Union’s economic and monetary union, i.e., of those Member States which have adopted the euro as their currency. [...] Second, given that virtual currencies are not in fact currencies, it would be more accurate to regard them as a means of exchange, rather than a means of payment”.

It has also been argued Bitcoins might be defined as a type of financial instrument<sup>19</sup>. From an economic point of view, a financial instrument is a type of investment. However, the juridical definition of financial instrument changes, sometimes radically, from State to State. In the USA, according to Section 77 (b) of the 1933 Securities Act “any note, stock, treasury, security future, security-based swap, bond [...] investment contract [...] or, in general, any interest or instrument commonly known as ‘security’”<sup>20</sup>. The US Courts usually determine if an interest can be treated as a financial instrument with the Howey test. Briefly, in the SEC v W.J. Howey Co. Case<sup>21</sup>, the Court stated that it is first necessary to find out what an investment contract is, in order to determine what can be included in the definition of financial instrument<sup>22</sup>.

However, if we applied said test to Bitcoin, it would be impossible to consider it as a financial instrument.

As an alternative, Bitcoin may be defined as raw materials. A peculiarity of such goods is that their quality remains average among the various producers. Every raw material must satisfy three conditions to identify as such: they must be standardized; they are ready use once delivered; their price must vary enough to justify the creation of a market. Typical examples of raw materials are those related to energy (gas, coal, oil), precious metals (gold, silver, copper) and agricultural goods (wheat, oil, coffee).

In September 2015, the U.S. Commodity and Futures Trading Commission (CFTC) issued its first action against a non-registered platform that traded options on Bitcoins, holding that Bitcoin, like the other cryptocurrencies, qualified as raw material for the purposes of the Commodity Exchange Act (CEA)<sup>23</sup>. Indeed, defining cryptocurrencies as raw goods gives rise to two doubts: first, raw materials are commonly used to satisfy primary needs; second, unlike traditional raw materials, the quantity of cryptocurrencies is potentially unlimited.

Conversely, it has been stated that the currencies of those countries that have a large availability of raw materials or natural resources have long been accepted as raw materials themselves<sup>24</sup>.

Despite the opinion of the CFTC, it may be argued that cryptocurrencies and raw materials satisfy, in principle, different needs and, thus, do not have the same functions.

Considering how difficult it is to define cryptocurrencies, the solution could be including them in the more general category of the intangibles<sup>25</sup>.

To sum up, none of the previous definitions seems to be suitable for the concept of Blockchain. Given this situation of uncertainty, it might be necessary to create statutory tools that may be useful to effectively rule the phenomenon of cryptocurrencies<sup>26</sup>.

### 3. Regulating cryptocurrencies from a Tax Law perspective

#### 3.1. The U.S. approach

As it often happens, the U.S. play a pivotal role when it comes to deal with new phenomena like new technologies. Therefore, it is not surprising that the U.S. have recently introduced a statutory definition of the concept of cryptocurrency and cleared out the tax treatment of the profits deriving from them, at least for the

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<sup>19</sup> See SONDEREGGER D., ‘A Regulatory and Economic Perplexity: Bitcoin Needs Just a Bit of Regulation’, in Washington University Journal of Law & Policy, [2015], 47, 175.

<sup>20</sup> 15 U.S.C.S. § 77b.

<sup>21</sup> SEC v W. J. Howey Co., 328 U.S. 293 [1946].

<sup>22</sup> The Howey Test establishes if an investment contract and, consequently, a financial instrument, is “a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificate or by nominal interests in the physical assets employed in the enterprise”.

<sup>23</sup> See in Re Coinflip Inc. et al., CFTC Docket n. 15-29 (CFTC Filed September 17, 2015) <https://www.irs.gov/pub/irs-drop/n-14-21.pdf>.

<sup>24</sup> See PERRY B., Forex Currencies: Commodity Pairs (USD/CAD, USD/AUD, USD/NZD), INVESTOPEDIA.

<sup>25</sup> In this respect, see FERRARI E., ‘Bitcoin e criptoalute: la moneta virtuale tra Fisco e antiriciclaggio’, in Il Fisco, [2018], 9, 861.

<sup>26</sup> See HARASIC V., ‘It’s Not Just About the Money: A Comparative Analysis of the Regulatory Status of Bitcoin Under Various Domestic Securities Laws’, in American University Business Law Review, [2014], 3, 487. The Author points out that “if not properly regulated, Bitcoin has the potential to create a disruptive and risky new global monetary system. Bitcoin not only poses grave money-laundering dangers, but also, it has the tendency to result in drastic price fluctuations, which may create various risks for users and investors in bitcoin-based financial products. Notably, regulators should seek a solution that will provide proper oversight and investor protection, without discouraging economic growth and investment”.

purpose of federal taxes<sup>27</sup>. Before this long awaited and desired result was finally reached, the IRS (Internal Revenue Service) and the U.S. Courts had to face huge difficulties in coping with the hideous problem of cryptocurrencies. In particular, in 2014 the IRS issued a note aimed at outlining some general principles regarding such currencies<sup>28</sup>.

For the purpose of the federal taxes, virtual currencies are to be treated as “property”. According to the IRS, the general tax principles applicable to transactions regarding properties shall apply also to transactions involving virtual currencies.

Also, the taxpayer who receives cryptocurrencies in exchange for goods or services, when filing in their tax return, must include the fair market value of such currencies measured in US dollars, at the time the taxpayer received them.

According to the IRS, if the taxpayer holds bitcoins for a certain amount of time, they would be subject to the tax treatment applied to capital gains<sup>29</sup>. The problem with the interpretation of the US Tax Administration is that Bitcoins are not just “property” but also currencies, and this gives rise to uncertainties<sup>30</sup>.

To start with, Bitcoin gives birth to a high risk of tax evasion<sup>31</sup>. According to certain commentators, Bitcoin may become a new offshore bank system, which might be used to avoid the application of taxes on capital gains<sup>32</sup>. Chances are that cryptocurrencies at issue may be used as a tax haven, since, for instance, they would guarantee total anonymity to their owners, which would make it hard for the IRS to verify if the taxpayer had obtained any gains or incurred losses.

Secondly, there might be some administrative problems: determining the tax base<sup>33</sup> (and, consequently, the capital gains) could be particularly tough for the taxpayers, considering that virtual currencies can be purchased at different prices, from different sellers and at different times<sup>34</sup>. Also, the IRS Note does not give any hints on the tax treatment of Bitcoin loans<sup>35</sup>.

Finally, defining cryptocurrencies as property could not be the best approach, from a U.S. point of view, since the definition of the rights concerning property are defined by States’ law (not by Federal law) and the ways these rights can be exercised significantly change from currency to currency<sup>36</sup>.

Despite the principles enshrined in the I.R.S. Note, the Virtual Currency Tax Reform Act classifies Bitcoins as foreign currencies, because adopting the definition of the I.R.S. would imply that transactions involving cryptocurrencies would be subject to capital gain tax. Pursuant to the statute at issue, the I.R.S. cannot apply the capital gain tax until five years have passed since it enters into force.

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<sup>27</sup> Virtual Currency Tax Reform Act, H.R. 4602, May 7<sup>th</sup>, 2014. Curiously, this statute was proposed by MP Steve Stockman (Texas), who was the first member of the U.S. Congress who accepted funds in Bitcoin for his election campaign.

<sup>28</sup> See IRS Notice 2014-21, 2014-16, I.R.B. 938 March 25<sup>th</sup>, 2014.

<sup>29</sup> In this respect, see PRENTIS M., ‘Digital Metal Regulating Bitcoin as a Commodity’, in *Case Western Law Review*, [2015], 66, 609. The Author underlines that “[...] to qualify a bitcoin as a capital asset, the taxpayer would have to not be holding the bitcoin as ‘stock in trade’ or be a ‘dealer of bitcoins’. Any gain from a bitcoin transferred after being held for more than a year would be considered a capital gain. Conversely, if a taxpayer holds bitcoins as inventory in his business, the disposition of the bitcoins would be treated as ordinary gain or loss”. See also ROMAN J.A., ‘Bitcoin: Assessing the Tax Implications Associated with the IRS’s Notice Deeming Virtual Currencies Property’, in *Review of Banking & Financial Law*, [2018], 34, 451.

<sup>30</sup> See MIRJANICH N., ‘Digital Money: Bitcoin’s Financial and Tax Future Despite Regulatory Uncertainty’, in *De Paul Law Review*, [2014], 64, 237.

<sup>31</sup> In this respect, it is necessary to point out that the U.S. Treasury’s Financial Crimes Enforcement Network (“FinCEN”) held exchanges in cybercurrencies are to be meant as business activities consisting in “money service businesses” (MSB).

<sup>32</sup> See MARIAN O., ‘Are Cryptocurrencies Super Tax Havens?’, in *Michigan Law Review First Impressions*, [2013], 38, 38; SLATTERY T., ‘Taking a Bit out of Crime: Bitcoin and Cross-Border Tax Evasion’, in *Brooklin Journal of International Law*, [2014], 39, 829.

<sup>33</sup> See ELLIOTT A., ‘Collection of Cryptocurrency Customer-Information: Tax Enforcement or Invasion of Privacy?’, in *Duke Law & Technology Review*, [2017], 1, 1. According to the Author “[...] the Notice leaves taxpayers wondering how they are supposed to maintain sufficient records to calculate the tax due. Especially for users who conduce numerous transaction a day, as well as for those that consistently use Bitcoin as a method of payment for everyday consumption, keeping track of the basis for every Bitcoin is unduly burdensome and arguably impossible”. See also CHODOROW A., ‘Rethink Basis in the Age of Virtual Currencies’, in *Virginia Tax Review*, [2017], 36, 371.

<sup>34</sup> LAMBERT E.E., ‘The Internal Revenue Service and Bitcoin: A Taxing Relationship’, in *Virginia Tax Review*, [2015], 35, 88. The Author highlights that “[...] taxpayers lack an authoritative resource to determine the value of their bitcoins since unlike stocks, bitcoins are not actively traded on a regulated market”.

<sup>35</sup> See SHAPIRO D.C., ‘Bitcoin Loans and Other Cryptocurrency Tax Problems’, in *Journal of Taxation of Investments*, [2017], 33.

<sup>36</sup> See ANTONIKOVA N., ‘Real Taxes on Virtual Currencies: What Does the I.R.S. Say’, in *Virginia Tax Review*, [2015], 34, 433.

The Virtual Currency Tax Reform Act justifies the equivalence between bitcoin and foreign currencies exclusively with the following statement: bitcoins play the same role as foreign currencies. For the purpose of the statute at issue, a virtual currency is defined as a digital representation of value that functions as a medium of exchange, a unit of account, and/or a store of value.

### 3.2. The EU approach

As it is well-known, the EU does not have a full competence in the area of direct tax law, but it does have a direct competence in the field of VAT. It is no surprise, then, that the first judgment of the ECJ regarding cryptocurrencies involves the application of the VAT Directive<sup>37</sup>.

In the case at issue<sup>38</sup>, the ECJ had to establish if the activity carried out by Mr. Hedqvist, consisting in the exchange of traditional currencies with virtual currencies and vice versa, represented a provision of services pursuant to art. 2, paragraph 1, of the VAT Directive and, in this case, if art. 135, paragraph 1, of such Directive were to be interpreted meaning that the exchange activities at issue were tax exempt.

On October 14<sup>th</sup>, 2013, the Swedish Tax Administration had previously held that, lacking a definition of cryptocurrency in the VAT Directive, it was to be treated as a means of payment.

The Skatteverket stated the Bitcoin exchange required the same conditions as the financial intermediation of financial instruments and Bitcoin could be used as well as any other means of payment having legal tender.

Consequently, transactions in such a currency were to be considered as VAT exempt, pursuant to art. 135, paragraph 1, letter e, VAT Directive<sup>39</sup>.

First, the ECJ established the transactions involving the exchange of Bitcoin were to be deemed as supply of services pursuant to art. 2 VAT Directive.

Then, for what concerns the VAT regime of such transactions, the Court held the provisions set forth in art. 135, paragraph 1., letter e, applied to the transactions at issue. The Court argued that, since *“it is common ground that the ‘bitcoin’ virtual currency has no other purpose than to be a means of payment and that it is accepted for that purpose by certain operators”*<sup>40</sup>, interpreting the provision in question as if it ruled only transactions in traditional currencies would result in depriving it of its effects<sup>41</sup>. As it has been correctly pointed out, the solution given by the ECJ could work only as long as the transaction consisted in an exchange of bitcoin with other virtual currency, while it could not be applied if bitcoin were exchanged with goods or services<sup>42</sup>.

Once the EU approach has been introduced, it is possible to focus on the Italian approach.

### 3.3. The Italian approach

Italy has not introduced any piece of legislation that sets forth provisions on virtual currencies. This is why the above-described judgment represents a lighthouse and a starting point for the decisions the Italian Tax Administration has made so far<sup>43</sup>.

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<sup>37</sup> Directive 2006/112/EC of the Council of November 28<sup>th</sup>, 2006 L 347/1 on a common VAT system.

<sup>38</sup> Case C-264/14 Hedqvist v Skatteverket, ECJ 5<sup>th</sup> Section, October 22<sup>nd</sup>, 2015.

<sup>39</sup> For a quick exam of the opinions of the EU Member States on Bitcoin, see CAPACCIOLI S., ‘VAT & Bitcoin’, in EC Tax Review, [2014], 6, 361. The Author gives also his own interpretation, claiming *“[...] bitcoin acts like a security and the failure of an issuer is not decisive under VAT Directive”*.

<sup>40</sup> Case C-264/14 Hedqvist v Skatteverket, ECJ 5<sup>th</sup> Section, October 22<sup>nd</sup>, 2015, paragraph 52. In the following paragraph, the ECJ holds that: *“it must be held that Article 135(1)(e) of the VAT Directive also covers the supply of services such as those at issue in the main proceedings, which consist of the exchange of traditional currencies for units of the ‘bitcoin’ virtual currency and vice versa, performed in return for payment of a sum equal to the difference between, on the one hand, the price paid by the operator to purchase the currency and, on the other hand, the price at which he sells that currency to his clients”*. See PIASENTE M., ‘Esenzione IVA per I “bitcoin”: la strada indicata dalla Corte UE interpretando la nozione di valore’, in Corriere Tributario, [2016], 2, 141.

<sup>41</sup> The ECJ did not rule on the application of VAT provisions to the mining activity. In this respect, see WOLF R., ‘Bitcoin and EU VAT’, in International VAT Monitor, [2013], 254. According to the Author, also the mining activity is ruled by art. 135 VAT Directive and is, thus, VAT exempt. See also SPAZIANTE F., ‘Le operazioni concernenti I “bitcoin”: la declinazione pratica dei principi espressi nella sentenza Hedqvist’, in Fiscalità e Commercio Internazionale, [2016], 8, 29.

<sup>42</sup> In this respect, see PALUMBO G., ‘Il trattamento tributario dei bitcoin’, in Diritto e Pratica Tributaria, [2016], 1, 2079.

<sup>43</sup> Response n. 72/E September 2<sup>nd</sup>, 2016 and Response n. 14 to tax ruling n. 956-39/2018.

While the answers of the Italian Tax Administration regarding the application of VAT are not groundbreaking, as they simply copy and paste what the ECJ had previously held in the Hedqvist Case, they certainly appear more interesting when they deal with direct taxation.

First, the Tax Administration states that the activities of buying and selling of cryptocurrencies and exchanging virtual currencies with traditional currencies are relevant for the purpose of the Italian Tax on Company Revenue (IRES, Imposta sul Reddito delle Società), the Italian Tax on Individual Revenue (IRPEF, Imposta sul Reddito delle Persone Fisiche) and the Italian Tax on Regional Productive Activities (IRAP, Imposta Regionale sulle Attività Produttive).

In the first case, a limited liability company asked the Italian Tax Administration if the provision of services concerning the use of virtual currencies, such as the purchase and the sale of Bitcoin for its customers would be subject to IRES. In response, the Italian Tax Administration held IRES would apply to the gain obtained by the company, consisting in the difference between the purchase price and the sale price. Such gain is to be considered as an income deriving from the supply of financial services<sup>44</sup>.

In other words, the Italian Tax Administration considered the business activity carried out by the requesting company equal to the provision of financial services, not having regards to the intrinsic characteristics of Bitcoin and held that such activity was subject to IRES and IRAP. For what concerns the Bitcoins remaining at the end of the fiscal year, they must be valued at fair value, pursuant to art. 9, Italian Tax Code, Presidential Decree n. 917, December 22<sup>nd</sup>, 1986 (TUIR, Testo Unico sulle Imposte sui Redditi).

In the following response, the Italian Tax Administration cleared out that activities such as virtual currency exchange, if not carried out by a business enterprise, give rise to “other income”, taxable pursuant to art. 67, paragraph 1, letter *c-ter* and paragraph 1-*ter* TUIR, as much as it happens with activities involving traditional currencies<sup>45</sup>.

To sum up, according to the Italian Tax Administration, if a business activity consists in the exchange of virtual currency with traditional currency, the profits deriving from it are taxed as business profits. Conversely, if natural persons have bitcoins outside of their business activity, the income is taxed as “other income”.

Let alone the relevance for VAT purposes of the aforementioned activities, a remarkable topic the Italian Tax Administration did not deal with is the exchange of information, pursuant to EU Directive EU/2015/2376 (Common Reporting Standard, CRS) and tax monitoring, pursuant to Legislative Decree n. 90/2017.

More specifically, the Legislative Decree in question establishes service suppliers who deal with virtual currencies are deemed to comply with the money laundering provisions, as set forth by art. 3, paragraph 5, letter I, Legislative Decree November 21<sup>st</sup>, 2007, n. 231. In fact, those subjects are considered as a category of financial operators.

As it has been correctly pointed out, such a category includes not only the exchangers (those who exchange cryptocurrencies with traditional currencies), but also the wallet providers (those who provide services like the custody of the credential required to have access to virtual currencies)<sup>46</sup>.

Even though this is a step ahead towards the transparency of transactions involving bitcoins, it is necessary to keep in mind that in case the transactions do not involve intermediaries, but take place only between privates, or in case of mining, the parties of the transactions will still be anonymous<sup>47</sup>.

#### 4. Conclusions: a clash between two systems?

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<sup>44</sup> See CLAPS P. – PIGNATELLI M., ‘L’acquisto e la vendita per conto terzi di bitcoin non sconta l’IVA ma rileva ai fini IRES ed IRAP’, in *Corriere Tributario*, [2016], 40, 3073.

<sup>45</sup> The applicability of art. 67, paragraph 1, letter *c-ter* TUIR had already been suggested by commentators even before the response of the Italian Tax Administration. In this respect, see MOLINARO G., ‘Sono tassabili le manifestazioni di capacità economica emergenti nelle operazioni relative a Bitcoin?’, in *Il Fisco*, [2014], 25, 2447.

<sup>46</sup> See BIXIO I., ‘Valute Virtuali e adempimenti antiriciclaggio: riflessi sui soggetti obbligati, nuovi e non’, in *Corriere Tributario*, [2017], 34, 2676.

<sup>47</sup> See MAIORANA D., ‘Disciplina giuridica e fiscale delle criptovalute: sfida al legislatore dal web’, in *Corriere Tributario*, [2018], 8, 630.

Finally, after having shortly described some issues related to the world of cryptocurrencies and having given a glance at the US, EU and Italian approach, it seems necessary to highlight certain points.

To start with, it is impossible to deny the huge impact of the “virtual world” on the real world, which is evident now more than ever and, at the same time, the vulnerability of the latter and the inadequacy of the legal systems. What is baffling is that the governments and the Authorities – either administrative or jurisdictional – have tried to interpret the phenomenon of cryptocurrencies and the Blockchain technology under traditional paradigms, without realising how innovative they are. This has resulted in approximate and sometimes controversial applications of pre-existing provisions and in a puzzling and confusing mayhem where it is impossible it comes to finding out what to tax and how to tax it.

However, if we think about it, the Blockchain technology exists in a parallel and detached world, which has sometimes an overwhelming influence on the real world, and which can thrive in the absence of a central regulatory authority, because the principles it is based on have nothing to do with those you may find in democratic Constitutions.

In other words, democratic values are things you would not even mention in that context, which may sound quite scary. What is likely to happen is this developing virtual world, with its own rules and the lack of authorities will eventually clash with “our world”, made of deeply rooted principles, which is also facing a huge identity crisis. This apocalyptic scenario could only be evaded if the current authorities realised that the traditional juridical tools are not adequate and up to date and if they started to elaborate and process new categories and a new legal framework, which would allow to break through this nebulous barrier represented by the Blockchain world.